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Justifying your CPM investment– it's not just smoke and mirrors!

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I can't imagine a company that wouldn't be a lot more successful with a reliable, best-practice system for managing performance. But getting started can be a challenge: You have to sort through business issues, identify critical performance indicators, decide which systems need fixing or replacing, and take a hard look at benefits and costs. And once you've done all that, you need to figure out how to "sell" the idea in your company.

In this article, David Axson shows how you can use real-world data and analysis to make a case for investing in performance management. No smoke and mirrors—just hard facts.

"Justifying your CPM Investment" is the first in a new series of papers written for the IBM Cognos® Innovation Center by David Axson, founder and president of the Sonax Group. David is former Head of Corporate Planning at Bank of America and co-founder of The Hackett Group. In this series, David draws on research and material from his second book, Best Practices in Planning and Performance Management, which will be published by John Wiley & Sons in January 2007. The book provides practical insights into the ways world-class companies leverage corporate performance management processes and systems to attain and sustain superior performance.

Regards,

Jeff Holker
Associate Vice President
IBM Cognos Innovation Center for Performance Management

Common sense tells you that investing in performance management systems is worthwhile, but how do you build a compelling business case? In a recent Wall Street Journal article (11 Sep 06), Carol Hymowitz comments that "Many CEO's who don't want to step aside still rely on an antiquated strategic planning process that often doesn't help them make better decisions faster."

For many managers, the last four words—"make better decisions faster"—are the raison d'être for investing in corporate performance management (CPM). Today's ultra-competitive, volatile, and uncertain markets demand that managers are able to make high-quality decisions in real time. Traditional static budgeting and reporting processes that rely on the general ledger or ERP system to drive monthly or quarterly processes are increasingly seen as obsolete. CPM provides a set of tools that enables managers to structure their performance management processes to the rhythm of their business, not just to their accounting calendar.

Of course, few executives will green-light a major investment in new technology solely on the promise of potentially better decision-making—though maybe some should! So how do you put a value on better, faster decision-making or more accurate forecasts? The simple answer is, you can't in the traditional sense of building a straight cost-benefit analysis. But as with many other types of investment such as R&D, marketing, and training, it is possible to build a compelling case that combines real productivity gains with measurable improvements in effectiveness. The good news is that CPM investments can be justified in a more tangible way.

The key is to build the argument around both the objective: ("better decisions") and the process ("performance management"). Based upon my experience working with over 200 organizations in the area of performance management, this translates into describing the impact of CPM in four areas:

1. Process quality

2. Staff leverage

3. Risk mitigation

4. Decision quality

Process quality and staff leverage are the primary sources of cost or efficiency, while risk mitigation and decision quality are the sources of value or effectiveness (see Exhibit 1). Through a considered analysis of the likely impact on each of these four variables, it is possible to construct a business case that not only justifies your investment in CPM, but also serves as a baseline to measuring benefits realization. Let's look at each of the four elements in turn.

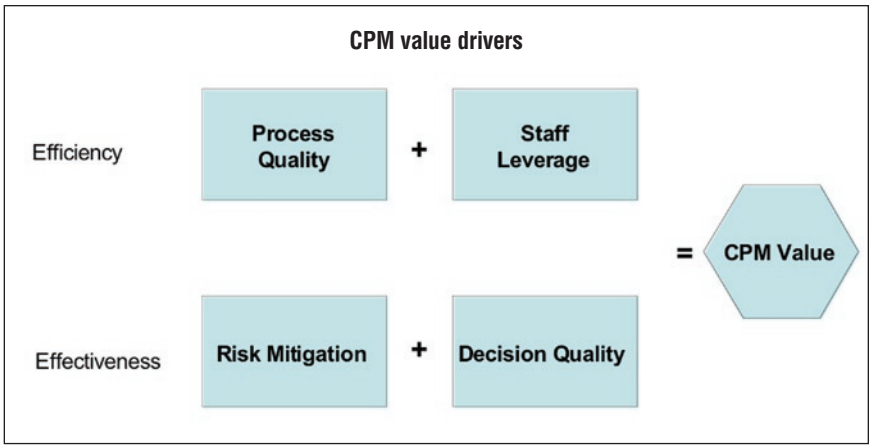

Exhibit 1

Process quality

For many years, companies have been wrestling with performance management processes that are either poorly integrated, slow, excessively detailed, incomplete, lack ownership and accountability, or in some cases, all of the above. Jack Welch went so far as to say that, "The budgeting process at most companies has to be the most ineffective practice in management" (Winning, Harper Business, 2005). His assertion was based upon the tendency for budgeting to become a negotiation process for setting performance targets rather than a planning process designed to drive superior performance. He is right, and most managers agree.

In the last few years, a new vision for performance management has emerged that is characterized by fast and flexible processes infused with timely information and insightful analysis that allows managers to set long term direction while also constantly fine-tuning tactics in response to opportunities and threats as they occur. The ability of CPM technology to support the collection, analysis, and communication of the information required to enable such a process is a defining characteristic of a world-class company.

The most effective measures of process quality address a combination of cycle time and accuracy. The ability to rapidly deliver accurate projections of future performance allows managers to make decisions with confidence. An organization that moves from Acceptable to Best-Practice in each of these areas will typically realize a threefold improvement in the productivity of their standard planning, budgeting, and forecasting processes.

Best-practice process metrics

Metric	Acceptable	Best practice standard
Forecast completion time[1]	< 3 days	<1 day
Forecast accuracy[2]	+/ 3%	+/ 1%
Annual plan completion time[3]	8 – 12 weeks	< 8 weeks

Metric definitions
[1] From request or trigger of a forecast activity to executive management approval
[2] Achievement of revenue and net income forecasts for the next quarter
[3] From the issuance of targets to Board approval

Staff leverage

For many years, benchmarks have highlighted the cost reduction opportunities that companies can realize in different business processes. Companies have successfully taken cost out of many finance processes resulting in a 60-65 percent decline in average finance function costs relative to revenue in the last 15 years; however many organizations have not been able to drive a corresponding increase in the value-added contribution of finance to the business. Why not? The reasons for this are twofold. First, the relative cost reductions have largely been achieved by supporting growing revenue streams with flat or declining finance staffs in basic accounting and transaction processing areas. This has been possible through a potent combination of new technology and best practices that have allowed core finance transaction processes to become increasingly more productive. By comparison, performance management and decision support processes have not reaped the same benefits, partially due to continued reliance on cumbersome ledger or ERP systems combined with a myriad of poorly managed spreadsheets for supporting critical planning, reporting, and forecasting processes.

The second reason is that the demands placed upon finance professionals are increasing exponentially as business managers seek to deal with more volatile and uncertain markets, while also addressing an endless stream of compliance issues from Sarbanes-Oxley through the creative dating of stock option grants. Such increased demands are being met with flat headcount budgets at best, so service levels inevitably suffer. This is where investments in CPM can pay off. The ability to support increased demand cost-effectively requires tools and technology that liberate financial staffs from the mundane.

The biggest efficiency gain from investing in CPM comes in the form of staff leverage. Enhanced staff leverage is accomplished in two ways: first, by increasing managers' ability to satisfy their needs directly through functional self service tools; and second by either eliminating or automating the lower-value tasks that consume so much professional staff time. There are three measures that can help companies size their overall opportunity:

1. The Staff Leverage Ratio

2. The Manager Support Ratio

3. The Value-Added Ratio

Let's look at each in turn. The Staff Leverage Ratio (or SLR) measures the ratio of productive, high-value work undertaken by professional staff versus lower value data manipulation and reporting activities. Examples of high- and low-value activities are shown in Exhibit 2. The SLR can be calculated for any group of manager and professional staff, and is particularly useful in areas such as finance, marketing, supply chain management, and human resources.

High value	Low value
• Direct dialogue with decision makers	• Data validation
• Development of business analyses	• Report creation
• Evaluation of risk and variability	• Spreadsheet model maintenance
• Team-based analytical reviews	• Data sourcing

Exhibit 2

Research by the Sonax Group (www.sonaxgroup.com) shows that the average SLR for U.S. companies is between 0.2-0.3; this means that only 20-30% of a manager's or professional's time is devoted to high-value work. With average fully loaded compensation for these positions typically in the range of $80,000- $150,000 per year, the waste is clear. Two examples will illustrate this:

Example A: Large telecommunications company
Total finance professional staff = 600 FTEs (full time equivalents)
Average compensation = $100,000
Current SLR = 0.25

For this company, achieving a target SLR of 0.5 (50% high value/50% low value) would allow for a 60% increase (90 FTEs) in high-value work, while reducing costs by $12 million (120 FTEs @ $100,000).

Example B: Medium size healthcare provider
Total staff = 50 FTEs
Average compensation = $80,000
Current SLR = 0.4

Achieving a target SLR of 0.7 (70% high value) would allow this company to increase high-value work by 40% (8 FTEs), while reducing costs by $800,000 (10 FTEs @ $80,000).

The economics are compelling; but beyond simple economic value are the incremental benefits that can be gained by offering richer and more rewarding roles to finance professionals, which can only help in attracting and retaining talent.

The Manager Support Ratio assesses the degree to which processes and systems have been optimized to allow business managers to complete many traditional performance management tasks on a self-service basis. This metric looks at the ratio of finance staff engaged in business support to the population of managers being supported. For an organization with 100 managers, a change in the support ratio from 1:5 to 1:10 can be worth $1 million a year.

Self service can be a contentious subject with some who believe it to be a waste for valuable management time to be consumed by processes like building budgets and developing forecasts, arguing that it is much better to have the finance staff perform such tasks. Some organizations choose to make these discretionary investments in order for finance to provide "concierge" service to a broad spectrum of operating managers. This is flawed thinking; as long as we strive to make these self-service tasks "value-added" by focusing management time on the key decisions they need to make, and eliminating all the lower-value tasks through the judicious application of process best practices and best- in-class CPM technology, the time investment is more than offset by increased understanding, accountability, and ownership.

The third measure is the Value-Added Ratio which is an internal measure of overall finance focus. It looks at the ratio of finance managers and professionals who are engaged in decision support and risk management activities versus those engaged in transaction processing. As I mentioned earlier, the overall ratio of finance costs to revenue has declined significantly over the last fifteen years, however there has been little change in the value added ratio – lower value work still consumes 60-65

percent of manager and professional staff time (Exhibit 3). The results of best-practice application and CPM deployment will show up in increased focus on the value-added role of finance in managing risk and directly supporting the making of better, faster decisions.

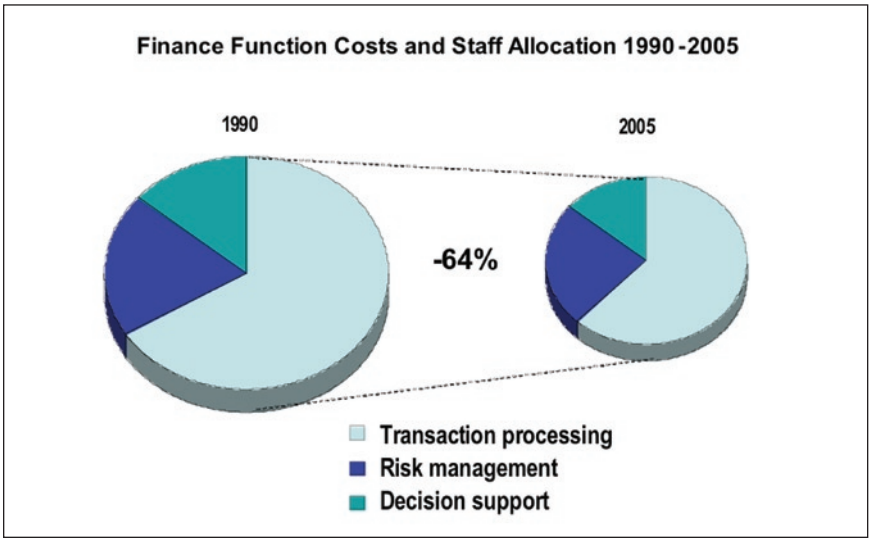

Exhibit 3

Metric	Acceptable	Best-Practice Standard
Staff leverage ratio[1]	0.5	0.25
Manager support ratio[2]	1:5	1:10
Value-added ratio[3]	1:1	1:1.5

Metric definitions
[1] Ratio of professional staff time spent on value added tasks versus lower value tasks
[2] Ratio of finance professionals and managers engaged in business support to the number of business managers being supported
[3] Ratio of managerial and professional finance staff engaged in transaction processing as opposed to business risk management and decision support

Taken together, these three measures establish the economic baseline for justifying your investment in CPM, and also address whether talented resources are being effectively utilized. An organization that can move from Acceptable to Best Practice across all three metrics will realize a 30 to 40 percent staff productivity improvement. Some of these benefits can be taken as headcount reduction, thereby reducing costs; and some can be reinvested to deliver yet more added value through the performance management process.

Risk Mitigation

Successful businesses take risks, as Peter Bernstein commented in his excellent book, Against the Gods – The Remarkable Story of Risk (John Wiley & Sons, 1996), "The capacity to manage risk, and with it the appetite to take risk and make forward-looking choices, are key elements of the energy that drives the economic system forward."

Risk-taking is fundamental to a company's ability to create value. Therefore, risk management must be a key element in an effective performance management process. This goes beyond traditional compliance and financial risks to encompass the effectiveness of the planning and performance management processes in:

- Identifying viable initiatives or projects in pursuit of agreed goals.
- Identifying those initiatives that are failing and rapidly taking remedial action or canceling them.
- Developing rational estimates of expected benefits and managing the realization of those benefits.

It is not unusual for a company to dedicate 20-30 percent of its total resources to new projects and initiatives: For a billion-dollar company, improving the yield on those investments by only 5 percent per year can deliver $15 million in value. Using CPM tools to develop a continuously updated view of the performance of key initiatives allows managers to rapidly identify both opportunities and threats that dictate changes in tactics. The ability to dynamically realign resources across the overall project portfolio is one of the hallmarks of a high performing organization.

Metric	Acceptable	Best-Practice Standard
Plan achievement[1]	Within 5% of target range	Within target range
Project benefit realization[2]	75%	90%

Metric definitions

[1] Achievement of revenue and net income goals assuming a target range is defined. Ranges should not exceed 5% of the mid-point

[2] The percentage of projects undertaken that yield at least 95% of the projected benefits.

Decision Quality

Ultimately, the acid test of any performance management process is the quality of resulting decisions. There has been considerable debate recently as to whether it is rational to try and measure performance management effectiveness in terms of business results. Many commentators argue that there are too many other variables at play to link one to the other. Some argue that great decisions may be undone by poor execution. I don't buy these arguments; neither should you. Effective performance management embraces all aspects of the management process from setting strategy, developing plans, and allocating resources, all through the monitoring of performance and the adjustment of tactics, so that failed execution means failed performance management. Failing initiatives should be detected early by the performance management process, thereby enabling management to take appropriate remedial action or – if necessary – cancel the program. If you accept this definition, then the only valid measure of performance management effectiveness is business success.

Any company that has average-or-worse performance in its chosen markets must make changes to some aspect of its performance management process. These changes may take place in leadership (as the ongoing parade of CEO firings demonstrates), process, organization, or systems. In most cases, changes in people, process, or organization require changes in systems. Hence, a key element in justifying any CPM investment is the expected upside in overall business performance.

Metric	Acceptable	Best-Practice Standard
Relative revenue growth[1]	At peer group average	#1 or #2 in peer group
Relative earnings growth[2]	At peer group average	#1 or #2 in peer group
Management satisfaction[3]	50% "top 2 box"	score 75% "top 2 box" score

Metric definitions

[1] Rate of revenue growth over a multiyear period (typically 3-5 years) relative to a peer group of industry competitors

[2] Rate of earnings growth over a multiyear period (typically 3-5 years) relative to a peer group of industry competitors

[3] Percentage of managers rating the performance management process a "9" or "10" on a ten point scale

Conclusion

A comprehensive CPM business case will establish baseline economics in terms of process quality and staff leverage improvements, while setting out clear measures of value added in terms of risk mitigation and decision quality. Taken together, these four elements allow organizations to craft a compelling rationale for upgrading their performance management processes. You will notice that this is not a "systems-only" argument, but an integrated view that combines people, process, and systems. Today more than ever, it is almost impossible to isolate the benefits of new systems from the benefits that accrue from improved processes and more effective, more productive staff. In the next paper we will discuss the importance of changing long held beliefs and engrained behaviors to fully leverage the best practice capabilities of CPM systems.

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The IBM Cognos Innovation Center was established in North America, Europe and Asia Pacific to advance the understanding of proven planning and performance management techniques, technologies, and practices. The Innovation Center is dedicated to transforming routine performance management practices into "next practices" that help cut costs, streamline processes, boost productivity, enable rapid response to opportunity, and increase management visibility.

Staffed globally by experts in planning, technology, and performance management, the Innovation Center partners with more than 3,000 IBM Cognos customers, academics, industry leaders, and others seeking to accelerate adoption, reduce risk, and maximize the impact of technology-enabled performance management practices.

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